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In the Supreme Court of the United States

OCTOBER TERM, 1972

Nos. 71-1680, 72-21, 72-24, 72-62

IN THE MATTER OF TENNESSEE CENTRAL RAILWAY COMPANY, ET AL., PETITIONERS

v.

A. BATTLE RODES, TRUSTEE OF TENNESSEE CENTRAL RAILWAY COMPANY, ET AL.

ON PETITIONS FOR WRITS OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SIXTH CIRCUIT

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals is not yet reported (R.R. Pet. App. 1-20).[1] The opinion of the district court is reported at 316 F. Supp. 1103 (R.R. Pet. App. 21-46).

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[1] "R.R. Pet. App." reference is to the Appendix to the petition filed by the railroads in No. 71-1680.

JURISDICTION

The judgment of the court of appeals was entered on February 2, 1972 (R.R. Pet. App. 1-15). A timely petition for rehearing was denied on April 4, 1972 (R.R. Pet. App. 53). The petitions for writs of certiorari were filed on June 23, 1972, in No. 71-1680, on July 1, 1972, in No. 72-21, on July 3, 1972, in No. 72-24, and on July 11, 1972, in No. 72-62. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTIONS PRESENTED

1. (a) Whether the federal statute giving the United States priority in insolvency proceedings for the debts due to it is applicable in a proceeding under Section 77 of the Bankruptcy Act.

(b) If it is, whether the statute is applicable to a claim of the United States, transferred from the Reconstruction Finance Corporation, which was not entitled to the priority of the United States at the time the loan was made.

2. If the statute is not applicable, whether the claims of "six months" creditors, asserting interline accounts and the furnishing of supplies and services to the railroad before it was placed in reorganization, are entitled to priority in payment ahead of the mortgage bondholders where no current income was diverted to the bondholders.

STATEMENT

The Tennessee Central Railway Company ("the debtor") is in reorganization under Section 77 of the Bankruptcy Act (11 U.S.C. 205); it ceased operations after selling its lines to other carriers. Petitioners are certain of the Tennessee Central's creditors: they are railroads, local government units, and industrial companies. The United States claims priority to the remaining assets of the debtor railroad under the federal insolvency statute (R.S. 3466, 31 U.S.C. 191) and as holder of all of the debtor's first mortgage bonds.

In December 1967, the debtor was placed in reorganization and a trustee was appointed. For several years before the debtor had operated at a loss; its income was insufficient to pay the costs of operation and no payment was made on the fixed charges. The debtor's losses steadily increased during this period from about $204,000 in 1963 to about $1,680,000 in 1967. The total loss during this 5-year period was about $4.5 million (J. App. 30).[2]

At the time the debtor was placed in reorganization, it was in default in the payment of interest on its bonded indebtedness, in payment of its equipment trusts, taxes due to various county and municipal authorities, the payment due to other railroads on interline accounts and per diem charges, and to suppliers. This situation had existed for more than six

[2] "J. App." reference is to tne Joint Appendix filed in the court of appeals.

months prior to the commencement of reorganization. As a result of its failure to pay its interline accounts with other railroads, the debtor either had been placed on a pre-payment basis (requiring payment before a connecting carrier would accept shipments, contrary to the ordinary practice) or was in the process of being put in that situation by the other carriers, at the time it was placed in reorganization.

Subsequent to being placed in reorganization, the debtor had no operating profit and was able to continue operation only through the sale of certain assets. This condition continued until August 31, 1968, when the debtor ceased all operations.[3]

The primary claim of the United States arises from two loans to the debtor made by the Reconstruction Finance Corporation ("RFC") and transferred to the Secretary of the Treasury when the RFC was abolished in 1957. At the time the debtor went into reorganization, it owed the United States more than $5,200,000 on these loans.[4]

The railroad petitioners seek recovery for interline claims totalling approximately $900,000, which accrued within the six months before the reorganization petition was filed. The local governments seek recovery of back taxes for periods prior to the filing of the reorganization petition totalling about

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[3] The remaining assets of the debtor, consisting of cash and property, totalled approximately $3 million; the claim of the government was more than $5 million.

[4] The United States also has freight damage, loss and overcharge claims totalling about $60,000.

$105,000.[5] The Koppers Company claims approximately $121,000 based upon the furnishing of crossties, and relies both upon the equitable principle giving priority in certain situations to claims that accrued within six months before receivership, and upon the Tennessee Code Anno. Section 65-1021, which grants priority to certain suppliers of a railroad. Humble Oil also has a claim under the "six months" rule for diesel fuel supplied to the debtor.

The district court held that R.S. 3466 is inapplicable in a Section 77 proceeding and that the interline carriers, suppliers and local taxing authorities have priority over the claim of the United States based on its mortgage bonds (R.R. Pet. App. 21-44). A divided court of appeals reversed (R.R. Pet. App. 1-15). Relying on *United States* v. *Key*, 397 U.S. 322, it ruled that the United States has priority in a Section 77 railroad reorganization proceeding under R.S. 3466 for debts due it over the other claimants involved herein.

ARGUMENT

The principal issue raised by petitioners—whether the priority of the United States under R.S. 3466 applies in railroad reorganizations under Section 77 of the Bankruptcy Act—is settled by *United States* v. *Key*, 397 U.S. 322. The other issues are of little general and even less prospective importance. The

[5] Petition No. 72-62 was filed by Wilson County, Tennessee, after the 90 day jurisdictional time limit applicable in civil cases.

Reconstruction Finance Corporation was abolished 15 years ago, and the two RFC notes involved here are the only ones still outstanding which evidence loans to railroads.

To prevail, petitioners must establish (1) that the United States' insolvency priority under R.S. 3466 is not applicable in railroad reorganization proceedings under Section 77 of the Bankruptcy Act, and (2) that they are within the class of unsecured creditors accorded an equitable priority as "six months creditors," or are otherwise entitled to a priority over the secured government claims. If petitioners fail on either ground, their claims cannot be sustained. The court below rejected petitioners' first contention and thus did not reach the second issue. We submit that this disposition of the case was correct. As noted in footnote 10, *infra*, however, we also believe petitioners' arguments with respect to the second issue are without merit.

1. Section 3466 of the Revised Statutes provides that in the case of an insolvent estate any debts due to the United States shall be "first satisfied." This priority was recently upheld by this Court in a Chapter X reorganization proceeding. The Court noted that Section 77 served as a model for Chapter X, and that "[n]othing in § 77 casts any doubt on the continued priority of the United States under § 3466." *United States* v. *Key*, 397 U.S. at 330. The Court concluded that "§ 3466 must apply according to its terms except where expressly superseded, or where excluded by a later enactment 'plainly inconsistent' with it." (*Id.* at 332).

To support their contention that R.S. 3466 is not applicable in a Section 77 proceeding, petitioners rely on Section 77(b), which provides:

> For all purposes of this section unsecured claims, which would have been entitled to priority if a receiver in equity of the property of the debtor had been appointed by a Federal court on the day of the approval of the petition, shall be entitled to such priority and the holders of such claims shall be treated as a separate class or classes of creditors.[6]

As the court of appeals recognized (R.R. Pet. App. 5), "[t]he difficulty with [petitioners'] argument is that section 77(b) contains no language arguably referring to or superseding the effect of § 3466." That court correctly interpreted the *Key* decision as holding that such an intention is not inferable from generalized provisions or rules dealing with priority in bankruptcy. Instead, these provisions are to be read consistently with R.S. 3466 as allocating the priorities among all creditors except the government. This Court's analysis of the legislative intention also required the result reached below.[7]

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[6] Aside from Section 77(n), pertaining to claims of injured employees, this is the only provision in Section 77 pertaining to priorities.

[7] Petitioners point out that the Court in *United States* v. *Key* was referring to the original Section 77, and not necessarily to Section 77, as amended in 1935 (R.R. Pet. 13-14). However, this Court's statements are fully applicable to the amended Section 77, since nothing in the amendments, nor in the legislative history, suggests any intention to alter the established priority of the United States under Section 3466. Compare this Court's comments with respect to the enactment in 1934 of Section 77B. See 397 U.S. at 331.

2. In addition to contending that R.S. 3466 is never applicable in a Section 77 proceeding, petitioners urge that R.S. 3466 does not apply because the claim of the United States is based upon RFC loans.[8] Petitioners point out that, when the loans were made, the RFC did not have the priority of the United States under R.S. 3466. See 15 U.S.C. (1964 ed.) 603. When the RFC was abolished effective June 30, 1957, by Reorganization Plan No. 1, however, this loan was transferred to the Secretary of Treasury, who has administered the loan since then (J. App. 294).[9] Thus,

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[8] With regard to the RFC aspect of the case, petitioners rely on *United States* v. *Guaranty Tr. Co.*, 280 U.S. 478. While that case has never been explicitly overruled, it is inconsistent with numerous subsequent decisions of this Court in addition to the *Key* case discussed above. See *Massachusetts* v. *United States*, 333 U.S. 611, 624-629; *United States* v. *Remund*, 330 U.S. 539; *United States* v. *Texas*, 314 U.S. 480; *United States* v. *Waddill Co.*, 323 U.S. 353; *Small Business Adm'n* v. *McClellan*, 364 U.S. 446.

[9] Reorganization Plan No. 1 of June 30, 1957, Section 2(d)(1), transferred to the Secretary of the Treasury all of the functions of RFC with respect to or arising out of "programs of financial assistance to railroad companies * * *" (J. App. 297). Section 3 of the plan entitled "Transfer of assets and liabilities" provided that "The loans, obligations, securities, capital stock, and other assets pertaining to the functions transferred by section 2 of this reorganization plan (including accrued interest thereon, and property acquired in connection therewith) and the liabilities, contracts, bonds, mortgages, notes and other instruments relating thereto are hereby transferred from the Corporation to the respective transferees" (*Ibid.*). Section 6 of the Reorganization Plan abolished the Corporation as of June 30, 1957. Since that date, the Department of the Treasury has uniformly treated all debts and obligations as owing to the United States of America.

ten years before petitioners' claims arose, the RFC loan became a claim of the United States. Any recovery on this claim will be deposited in the United States Treasury, and any non-payment is a direct loss to it (J. App. 296).

Even if the derivation of the claim were pertinent, the statute eliminating the RFC's priority was repealed prior to the transactions upon which the competing creditors base their claims. On September 6, 1966, the provision in 15 U.S.C. 603 was repealed, because it was obsolete. H. Rep. No. 901, 89th Cong., 1st Sess., p. 390.

This legislation further provided in Section 8 (80 Stat. 632):

> The laws specified in the following schedule are repealed except with respect to rights and duties that matured, penalties that were incurred, and proceedings that were begun, before the effective date of this Act * * *.

Since none of the petitioners' claims had arisen at the time of the repeal of 15 U.S.C. 603 in 1966, no rights and duties had matured, no penalties had been incurred and no proceedings had begun with respect to this statute. Thus, when petitioners' claim accrued, these loans had the same status as any other claims held by the United States.

Moreover, the source of a claim of the United States is not determinative of the applicability of R.S. 3466. See *United States* v. *Emory*, 314 U.S. 423, where the United States had acquired its claim from a private bank, which had no priority, under a gov-

ernment-guaranteed loan. The government was nevertheless held entitled to priority under R.S. 3466. See also *Wagner* v. *McDonald*, 96 F.2d 273, 275 (C.A. 8):

> Neither is there merit in the first contention; that, because the right of priority did not attach to the notes in the hands of the bank when they were executed, the attribute of priority was not created when they became the property of the United States. Under section 3466, priority of payment does not depend upon how the United States acquired title to the notes, nor upon their status prior to their transfer. Priority is the result of insolvency of the debtor and ownership of the claim by the United States.[10]

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[10] The petitioners' claim of priority over the government as "6 months" creditors was not reached by the court below and not discussed by petitioners. Therefore, no extended refutation of that claim is appropriate. However, under the particular facts of this case the claim is without merit, since there is no fund to which "6 months" creditors can look for payment, and the equitable considerations under which they might establish priority in the absence of such a fund are not present.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that the petitions for writs of certiorari should be denied.

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